

AGENDA

COMMITTEE ON AUDIT

Meeting: 4:30 p.m., Tuesday, March 14, 2000
San Jose State University
Student Union Ballroom

Stanley T. Wang, Chair
Harold Goldwhite, Vice Chair
Roberta Achtenberg
Neel I. Murarka
Dee Dee Myers
Joan Otomo-Corgel
Frederick W. Pierce IV
Ali C. Razi

Consent Items

Approval of Minutes of Meeting of January 25, 2000

Discussion Items

1. Status Report on Current and Follow-up Internal Audit Assignments, *Information*

**MINUTES OF MEETING OF
COMMITTEE ON AUDIT**

**Trustees of The California State University
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California
January 25, 2000**

Members Present

Stanley T. Wang, Chair
Harold Goldwhite, Vice Chair
Roberta Achtenberg
Joan Otomo-Corgel
Frederick W. Pierce IV
Ali C. Razi

Members Absent

Dee Dee Myers

Other Trustees Present

William Hauck, Chairman of the Board
William D. Campbell
Martha C. Fallgatter
Debra S. Farar
Laurence K. Gould, Jr.
Ralph Pesqueira
Charles B. Reed, Chancellor
Anthony M. Vitti

Chancellor's Office Staff

David S. Spence, Executive Vice Chancellor and Chief Academic Officer
Richard P. West, Executive Vice Chancellor and Chief Financial Officer
Douglas X. Patiño, Vice Chancellor, University Advancement
Jackie R. McClain, Vice Chancellor, Human Resources
Christine Helwick, General Counsel
Larry Mandel, University Auditor

Approval of Minutes

Chair Wang called the meeting to order at 3:29 p.m. The minutes of the November 16, 1999, meeting were approved as submitted.

Year 2000 Update

Chair Wang introduced Mr. Richard P. West, executive vice chancellor and chief financial officer, who presented the update.

Mr. West cited that there have been several previous reports to the board on CSU's Y2K progress. This report differs in that it reflects what actually happened. Mr. West said he was happy to report there were very few problems and that there was really very little to report. There were a handful of minor system issues and some plant-related issues, and those occurred only on a few of the campuses. He noted that our preparation was adequate and that there were no major consequences as a result.

Chair Wang said he was pleased with the report and thanked Mr. West and everyone who worked so diligently on the Y2K project.

Status Reports on Current and Follow-up Internal Audit Assignments

Larry Mandel, university auditor, noted the following:

Student Records and Registration – five audits have been completed, and an additional six are in the report writing stage and scheduled to be completed within the next few weeks.

Operation and Maintenance of Plant – five audits have been completed, two are awaiting responses from campuses, and three are in the report writing stage. Mr. Mandel explained that due to staff vacancies, the number of these reviews has been reduced by one from the original audit plan, and the total is now ten.

Continuing Education – eight audits have been completed, two are awaiting campus responses, and one is in the report writing stage.

Auxiliary Reviews – these reviews commenced in October 1999. Report writing is being performed for the five auxiliaries reviewed at the Northridge campus and three auxiliaries at the Fullerton campus.

FISMA – these audits are ongoing, and 10 of the 11 scheduled for last year have been completed. The remaining review will be carried forward into early this year.

Follow-up Reviews – Mr. Mandel indicated that 32 prior audits are being tracked. Executive Order 715, issued in late October, will serve as a guideline to help campuses address on- and off-campus student health and safety training issues, which will enable

them to implement the remaining open recommendation for the Occupational Health reviews. While most campuses have satisfactorily addressed this recommendation, three are currently developing policies. Mr. Mandel anticipates that this recommendation will be satisfactorily addressed prior to the next board meeting. Only one recommendation is outstanding for the Seismic Safety review, and Mr. Mandel stated he was confident that this item would be closed by the next board meeting. For the Risk Management reviews, recommendations remain open for six campuses.

Trustee Otomo-Corgel congratulated President Maxson, President Lyons, President Karnig, and President Rosser for satisfactorily addressing all recommendations on all audits.

Chair Wang congratulated the campuses for the progress made in closing the outstanding recommendations and added that the board would like to see recommendations on all new audits closed within one year. He stated that the board would also like to see resources allocated for campus internal audit training, which is to be developed by the Office of the University Auditor. He went on to explain that the campuses will be responsible for performing self-audits, which will help improve campus operations.

Assignment of Functions to Be Reviewed by the Office of the University Auditor for Calendar Year 2000

Mr. Mandel explained that, every three years, risk assessment questionnaires are sent to the campuses and the Chancellor's Office, and the objective is to determine the areas of greatest risk to the CSU. The results of this information are then communicated to the board and recommendations are made on the subject areas to be reviewed over the next three years. Mr. Mandel explained that, in addition to the three new subject areas to be performed, financial internal control reviews (FISMA), auxiliary organization reviews, and information system reviews (performed in conjunction with both FISMA and auxiliary reviews) will continue. Mr. Mandel added that information system reviews may be incorporated into certain parts of the subject area reviews.

Mr. Mandel referred to Attachment B of Agenda Item No. 3 and explained that the information contained in the attachment indicated the greatest areas of risk to the system. These items are either not currently being reviewed or have not been reviewed in the recent past. Based on the items listed, Mr. Mandel recommended that reviews of Hazardous Materials Management, Public Safety, and Student Health Centers be performed during calendar year 2000.

Trustee Razi inquired about reviews related to employee relations issues.

Mr. Mandel responded by stating that the Executive Audit Committee discussed this topic and, due to collective bargaining issues related to classifications and confidential employee issues, felt that this topic should be deferred and given further consideration next year.

The committee approved the following resolution:

RESOLVED, By the Committee on Audit of the Board of Trustees of The California State University, the 2000 internal audit plan, including FISMA, Information Systems, Auxiliary Organizations, Construction, Hazardous Materials Management, Public Safety, and Student Health Centers is approved.

Report on Construction Auditing in the CSU-1998/99

Mr. Mandel introduced the item and stated that, during fiscal year 1998/99, the CSU contracted with KPMG Peat Marwick, to perform construction auditing. During this period, KPMG completed six reviews. He then introduced Mark Thomas, KPMG's Systemwide Coordinating Partner, and asked Mr. Thomas to comment on the reviews.

Mr. Thomas provided an overview of the construction auditing process by stating that the first year of this process included making recommendations to improve such areas as systems, processes, overhead rates, and profit rates on change orders. He emphasized that, although the scope of the audit did not change much, there had been a significant change in several areas reviewed. In comparison to the prior year, many of the same issues were reviewed and the campuses have been responsive to the suggestions made by KPMG. Mr. Thomas reported that there had been a change in overhead profit rates, and revisions have been made to the project administration reference manual, which includes several recommendations made in connection with prior audits. Mr. Thomas went on to report that, for the most part, there were fewer findings related to math errors and overcharging, and he emphasized that his firm is performing post-construction audits that include such steps as reviewing the developer's records, comparing them to CSU records, and examining change orders. He pointed out that KPMG auditors are finding much fewer of these types of items and when they are found, they are relatively small in dollar amount. Mr. Thomas noted that the completed construction reviews include: Chancellor's Office New Headquarters Building; Long Beach Student Union Improvement Project; San Francisco Corporation Yard, Central Plant, Utilities Infrastructure I; San Luis Obispo Upgrade Utilities; and Stanislaus Professional Schools Building. An additional set of campuses will be reviewed this year.

Mr. Thomas explained that the KPMG auditors reviewed the results of this year's projects with Larry Mandel and discussed the approach, whether the changes were working, and whether it was necessary to focus on other areas that might give the CSU "more bang for the buck." Mr. Thomas went on to explain that some of the changes this year included a more comprehensive analysis of such items as architect/engineer contracts and the performance of more on-site visits on the installation of large machinery. Mr. Thomas explained that there are many things that take place during a construction project and, as a result, a great amount of judgment is involved in managing a project. Experts in the area of construction management are called upon, and KPMG evaluates the assessments made by these experts. Mr. Thomas added that significant progress has been made, there has been a considerable amount of success in several areas,

and there are no significant issues or changes to be made at this time. However, the idea of decentralizing the construction process will result in a new set of challenges. Because management teams will be in place at the individual campuses managing construction projects, we must ensure consistency and that the campuses are managing in accordance with Chancellor's Office guidelines and policies.

Dr. Reed encouraged continuance of the KPMG construction audits, stated that the system benefits from this service, and noted that there are very few systems that perform such audits.

Chair Wang inquired as to the criteria for determining which projects are to be reviewed and whether a committee chooses the projects to be evaluated.

Mr. Mandel explained that projects are chosen based on size. For calendar year 2000, six audits, which normally average \$15 to \$17 million per project, will be completed.

Trustee Hauck asked Mr. Thomas whether the audit reports include information other than routine recommendations.

Mr. Thomas responded by stating that there are a number of recommendations included in the completed projects. He explained that during such projects, auditors closely examine the records and change orders. Some recommendations address the tracking of change orders, and many are process-oriented rather than statements that an item was missed or an overcharge was made. Mr. Thomas emphasized that, while there may be a few routine recommendations, this is not the thrust of the completed audits.

Trustee Vitti asked about the follow-up process for these projects.

Mr. Mandel replied that follow-ups for construction audits are handled as are all other audits, which includes following up on recommendations to ensure they are satisfactorily addressed. He explained that construction records are maintained in the office of Capital Planning, Design and Construction (CPD&C) and the process is primarily handled in that office. The Office of the University Auditor then follows up to ensure the recommendations are implemented.

Trustee Vitti queried as to whether the follow-up information is given to the board.

Mr. Mandel affirmed that this information will be included in the status report on current and follow-up audit assignments.

Trustee Otomo-Corgel commented about the increasing number of construction projects and asked whether the hiring of an internal construction auditor would be feasible.

Mr. Mandel explained that, prior to the contract with KPMG, an internal auditor performed this function for approximately three years. After this individual left the CSU, a recruitment to hire a construction auditor was performed. However, an individual

possessing the required experience and qualifications was not found. The project was then opened for bid, and accounting firms were encouraged to submit proposals to perform this function for a three-year period. KPMG was awarded the contract, and their work has been satisfactory. This process will be reviewed so that we may determine whether hiring an in-house construction auditor or contracting with an outside firm would be the most beneficial to the system.

Trustee Otomo-Corgel commented that it appeared that the number of projects is increasing and she asked whether a sufficient amount of funds has been allocated to perform additional reviews.

Mr. Mandel indicated that if additional projects are to be completed, this would require a larger allocation directed to these projects.

Trustee Fallgatter asked for further clarification on the construction follow-up process.

Pat Drohan, assistant vice chancellor, capital planning, design and construction, explained that CPD&C reviews the recommendations to determine whether changes to our internal recordkeeping system can be made. He added that there is a project manual, which defines the procedures for managing capital outlay projects, and all campuses have access to this manual. He indicated that the CSU chief of construction management maintains this manual and periodically updates it based on audit results and other occurrences in the field. Mr. Drohan went on to state that the Contract General Conditions are maintained in CPD&C. When audit reports are released and there is concurrence on the recommendations, procedural changes are implemented to allow the recommendations to be used in practice.

Trustee Pesqueira stated that contracting with an external firm to perform audits of our construction projects sends a message to the public and the legislature that we are not afraid to allow a third party to review our records and practices. Additionally, when the recommendations are responded to, this is a strong statement that we are serious about getting “the biggest bang for the buck.” He then congratulated KPMG for the work performed and stated his preference that outside contractors continue to perform the construction audit function.

Trustee Razi indicated that it is important for the board to be apprised of any problems associated with these audits. He stated that it is not necessary to increase the amount of auditing unless specific problems are discovered.

Report on Systemwide Audit in Accordance with Generally Accepted Accounting Principles including the Report to Management

Mr. West noted there were two reports included with the agenda item and that he would address each one separately. He first referred to the full consolidated set of financial documents, which includes the balance sheet and the income statement for the entire university enterprise. The documents include all funding sources, including auxiliary

funding. The second report (the Single Audit Report) addresses our performance obligations to the federal government with respect to acceptance of federal contracts and grant activities.

Mr. West announced this was the third year of presentation of our full consolidated financial statements. The financial statements incorporate the 23 campuses within the CSU system as well as the 75 separately incorporated auxiliaries. Mr. West briefly outlined the various fund categories included in the report and their prescribed purposes. He also presented a short overview of the balance sheet contents.

Mr. West reported on the status of our response to a management letter received last year from the external auditors focusing on the systemwide issues of tax reporting and auxiliary organizations. Management's responses are included in the current report and some definite progress has been made on those concerns.

Mr. West stated that Mr. Thomas would provide more detailed information on the item. Mr. Thomas expressed his great relief at having come to completion of this year's reports. He presented a comprehensive overview of the process by which the audit is conducted from start to finish, and acknowledged the massive collaborative effort among the campuses, management, and the audit firm to successfully complete this arduous task. Mr. Thomas reinforced a few items of interest including the unqualified opinion on the financial statement; ability of the university to distinguish between the university proper and the auxiliaries with regard to the financial statement; and observation of a general strengthening of the university's financial position. His comments on the management letter were favorable in response to the university's efforts to address non resident alien taxation issues and transactions in relationship to auxiliary organizations.

Trustee Razi asked for some clarification on how land asset values are reflected in the report. He said they appeared to be book value and did not reflect actual worth. Mr. Thomas acknowledged that the values are historical in nature and agreed that fair market value upon land acquisition would indeed be a much different figure. Mr. West added that we have not made an estimate on the value of the land but rather on the improvement of it. This estimate calls for \$7 billion on replacement values for improvement of existing buildings.

Trustee Pesqueira asked for a definition of what "non resident alien" means as it relates to issues raised in the management letter. Mr. Thomas explained that it would be persons who are not U.S. citizens and who attend CSU classes, are speakers, consultants, or scholarship recipients, etc. Payments to these persons and the proper reporting and withholding requirements are the issues of concern here.

Chancellor Reed complimented the board on its handling of various audit issues. He thanked Mr. Thomas for his interventions and coordination on our behalf with regard to a number of important issues.

Trustee Wang expressed concern about the ability to complete audits of the 80 auxiliary organizations with current resources. He added that it was necessary to strategize and allocate sufficient resources to ensure that all necessary functions are performed.

Mr. Mandel commented that he would be able to make a better assessment of the resources needed to audit the auxiliaries after the first year of reviews. He stated that during the January 2001 board meeting, he will discuss whether funding is sufficient for this project. He went on to state that during this calendar year, the audit plan calls for reviews to be performed at 11 campuses, or audits of 36 auxiliary organizations.

Trustee Goldwhite referred to the last page of the management letter that addresses released time and asked whether this refers to reimbursed time purchased by auxiliaries for faculty.

Mr. Thomas responded in the affirmative.

Trustee Goldwhite stated that, in future descriptions, he would prefer to see the term “reimbursed” as opposed to “released” as this is a reimbursement and no one is released. He indicated that a change in terms would clarify that individuals are paid for a portion of their teaching load.

Single Audit Report of Federal Funds

Mr. Thomas explained that the Single Audit Report addresses compliance and internal controls surrounding federal funds received by the CSU. In the CSU’s case the majority of those funds are targeted for student financial aid and FEMA requirements.

There was only one finding in the single audit report. The issue deals with unofficial withdrawals. This is when students simply stop coming to school and how to determine when they do; and how to calculate the various refunds to programs and other financial implications involved. Mr. Thomas cited it is an extremely difficult issue to tackle; nevertheless, it is one that the federal government requires the CSU to identify. In concluding his remarks, he commended the university for its overall achievements and for the progress made toward rectifying identified concerns.

Adjournment

The meeting adjourned at 4:17 p.m.

BRIEF

Information Item

Agenda Item 1

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

Presentation By

Larry Mandel
University Auditor

Summary

This item includes both a status report on the 2000 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Auxiliary Organizations, Hazardous Material Management, Student Health Centers, Public Safety Information Systems and Construction. In addition, follow-up on past assignments (FISMA, Risk Management, Continuing Education, Student Records and Operations and Maintenance of Plant) is currently being conducted on 35 prior campus reviews. Attachment A, summarizing the reviews in tabular form, will be distributed at the committee meeting.

ITEM

2

Agenda Item 1

March 14-15, 2000

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

At the January 2000 meeting of the Committee on Audit, an audit plan calling for the review of the following subject areas was approved: FISMA (Financial Internal Controls), Auxiliary Organizations, Hazardous Materials Management, Student Health Centers, Public Safety, Information Systems, and Construction.

FISMA

The audit plan indicated that approximately 130 staff weeks of activity (18 percent of the plan) would be devoted to auditing financial internal controls on 12 campuses. Report writing is being completed for one campus review, while fieldwork is continuing at three campuses.

Auxiliary Organizations

The audit plan indicated that approximately 165 staff weeks of activity (23 percent of the plan) would be devoted to auditing internal compliance/internal control at 11 campuses. Fieldwork is currently taking place at one campus/four auxiliaries.

Hazardous Materials Management

The audit plan indicated that approximately 101 staff weeks of activity (15 percent of the plan) would be devoted to a review of 11 campuses on training; inventory procedures; labeling and other forms of warnings; Material Safety Data Sheets (MSDS); hazardous waste registration, permit, and manifesting; emergency and contingency planning; and, hazardous waste disposal programs. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Student Health Centers

The audit plan indicated that approximately 101 staff weeks of activity (15 percent of the plan) would be devoted to a review of 11 campuses on establishment of health services and fees; qualifications and continuing education of SHC practitioners; control of fee revenue; budgetary controls; expenditures; maintenance of SHC accreditation status; security of medical records; and pharmacy controls. The audit program for this subject is currently being field tested by the audit

manager in charge of the project.

Public Safety

The audit plan indicated that approximately 101 staff weeks of activity (15 percent of the audit plan) would be devoted to a review of 11 campuses on communication of policies and procedures; relationships with external agencies; compliance with state-mandated POST standards and training requirements; budgetary and expenditure controls over public safety and parking funds; administration and accounting for POST funds and other special monies; cancellation of parking citations; accumulation and reporting of crime statistics; access controls over law enforcement data and confidentiality of records; effective use of physical assets and human resources; and controls over crime scene evidence and public safety equipment. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Information Systems

The audit plan indicated that approximately 40 staff weeks of activity (5 percent of the plan) would be devoted to review of systemwide projects such as Year 2000, Disaster Recovery, Collaborative Management Systems (CMS), Systemwide Internal Partnership (SIP), and Electronic Commerce. In addition, training and support will be provided in the area of financial internal controls (FISMA) for both campus and auxiliary audits. Review and training are ongoing.

Follow-ups

The audit plan indicated that approximately 25 staff weeks of activity (3 percent of the plan) would be devoted to follow-up on prior audit recommendations. The Office of the University Auditor is currently tracking 35 prior audits (FISMA, Risk Management, Student Records, Operation and Maintenance of Plant, and Continuing Education) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

Consultations and Investigations

The audit plan indicated that approximately 43 staff weeks of activity (6 percent of the plan) would be devoted to campus consultations and special requests. The Office of the University Auditor is periodically called upon to provide consultation to the campuses and/or to perform special audit requests made by the chancellor. Typically, the special requests are investigative in nature and often are the result of alleged defalcations or conflicts of interest.

Construction

For the 1999/2000 fiscal year, six construction projects are being reviewed by KPMG Peat Marwick with coordination from the Office of the University Auditor. Areas under review include change orders, project management services, contractor compliance, liquidated damages, close out documents, and cost verification of major equipment and construction components. Five of the projects are in the fieldwork or report writing stage at this time.